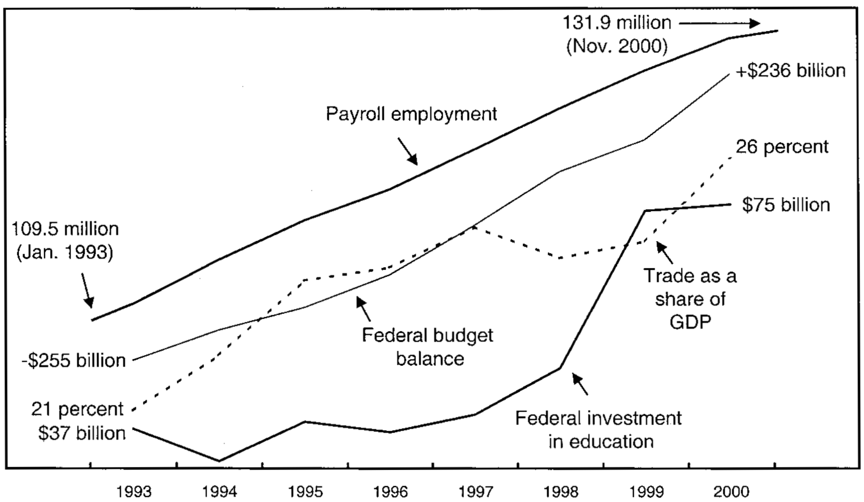
C O N C L U S I O N

Achievements and Challenges in the New Economy



Note: Investment in education is the sum of appropriations to the Department of Education, the E-Rate program, and tax credits, deductions, and deferrals for education. Trade is the sum of imports and exports.
Sources: Department of Commerce (Bureau of Economic Analysis), Department of Labor (Bureau of Labor Statistics), Office of Management and Budget, and Universal Service Administrative Company.

Fiscal discipline, investing in education, and encouraging trade led to a robust expansion that has created over 22 million jobs.

The past 8 years have been a period of extraordinary achievement for the U.S. economy. With support from sound policies and strategic investments in the future, the United States has experienced an unprecedented economic expansion. This expansion is remarkable not only for being the longest ever recorded but also for its breadth and inclusiveness. Its benefits have been widely and generously shared, raising Americans' average real income to record highs and creating opportunities for groups that have long been left behind.

The economy this expansion has created is not just greater in sheer size but "new" in its structure and performance. It is dramatically more information intensive and more technology driven, more productive and more innovative. Today's economy utilizes new, more efficient business practices and has redefined many traditional relationships between suppliers, manufacturers, investors, and customers to achieve ever-greater efficiency. The cumulative result of these trends and their interactions is a New Economy, one that is currently providing Americans in all walks of life the benefits of high growth, low inflation, high productivity, rising incomes, and low unemployment.

The New Economy did not emerge by chance. A policy strategy centered on fiscal discipline, investment in education and technology, and opening markets abroad has been key to its development. Prudent policy choices, sustained over 8 years, have fostered the flourishing of innovation and entrepreneurship. The combination of private sector innovation, new technologies, Americans' hard work, and sound policies and investments in the future has created vibrant economic growth. On average since 1993, the economy has grown at a healthy 4.0 percent per year. Core inflation has remained near its lowest rate since the 1960s. Meanwhile productivity growth has risen rather than stagnated over the course of the expansion. Productivity has grown 3.9 percent a year on average over the past 2 years, and it grew a robust 4.8 percent in the 12 months ending in the third quarter of 2000.

Importantly, the resulting prosperity has been shared in a remarkably equitable manner compared with the previous expansion. There have been solid, across-the-board income gains, with some of the strongest gains realized among the least well off. Americans in the bottom 20 percent of the income distribution have actually seen much stronger average income growth than the average for all other income groups: a total real gain of 16.3 percent since 1993. In the last 8 years the economy has created more than 22 million jobs, more than 80 percent of which are good jobs in industries paying wages above the median. The median family income has increased by $6,338 since 1993, rising to $48,950 in 1999. Meanwhile 7 million Americans have been lifted out of poverty. Home ownership reached 67.7 percent last year—the highest percentage on record. Unemployment is at its lowest level in more than 30 years. Unemployment rates for African Americans and Hispanics are at their lowest on record.

This *Report* has explored the phenomena that together have come to be known as the New Economy. It has examined the driving forces of innovation, organizational change, and sound policy that have created that New Economy. It has analyzed the effects those forces have had on macroeconomic performance, on business practices, and on our ability as a Nation to address the longstanding challenges of reducing poverty, improving education, and enhancing the long-term welfare of all our citizens. Last but not least, the *Report* has considered those areas where growth on its own may not meet all the challenges, and where targeted government policies can help widen the circle of opportunity to include as many of our fellow citizens as possible.

The United States today stands at a unique juncture in its own history—and indeed in world history. It enjoys unprecedented prosperity and therefore faces a unique set of opportunities as well as challenges. Used wisely and cautiously, our prosperity can be harnessed in ways that will further enrich all Americans for decades to come. We can and should continue to strengthen research and development, to drive long-term innovation and further productivity increases. We can and should continue to invest in education and training, to build the skills and ingenuity of our work force. And we can and should continue to shore up Social Security and Medicare, to improve our ability to provide for the long-term needs of our aging population. The right path, in short, is one that continues the policies of the last 8 years. Those policies have created a virtuous cycle in which fiscal discipline helps keep interest rates attractive for investment, and strong, productive investment in turn generates a healthy and growing economy, yielding ever larger budget surpluses.

Today's economy is strong, but it is far from invulnerable. The virtuous cycle can all too easily be broken if fiscal discipline is abandoned and priority is given to large tax cuts for a few rather than long-term investments for the country as a whole. Abandoning fiscal discipline in favor of a large, permanent cut in tax rates would raise interest rates and threaten investment and growth. Such a reversal of policy would be particularly ill advised at a time when the country faces a significant demographic challenge: over the next 40 years the share of the U.S. population aged 65 and over will rise from about 12.5 percent to nearly 21 percent. This demographic shift alone implies that retirement and health programs for the elderly will take up an increasing share of Federal outlays. But in addition, the costs per capita of Social Security and Medicare are expected to rise in the future, implying an even more dramatic increase in spending on the elderly. The confluence of these two trends means that spending on Social Security and Medicare as a share of GDP will almost double over the next 40 years, from around 6 percent today to 11.2 percent in 2040.

The emergence of the New Economy provides a precious opportunity to continue to build for the future, educate our children, secure the well-being of older generations now and for decades hence, and make the investments that will fuel the engines of innovation, enterprise, and productivity in our economy. Defining and pursuing the right priorities for continuing the expansion will be critical to the Nation's long-term welfare.

Technology's Role in the New Economy

At the heart of the New Economy is a bubbling cauldron of creativity and innovation. Advances in computing, information storage, and telecommunications have proliferated, yielding whole arrays of new products, services, and industries. Discoveries in all these fields have been decades in the making, but for most of that time they proceeded on separate tracks, with little joint impact on productivity and output. Recently, however, the paths of these technologies—telecommunications, computers, and the Internet—have converged, opening the way to a whole new range of capabilities previously unimagined.

Through the dynamic interaction of these powerful innovations, the economy has become "lighter," shifting toward products that embody more knowledge capital and less physical capital. Spending on information technology has played a leading role in the acceleration of economic growth. Although it accounts for an estimated 8.3 percent of GDP, information technology contributed almost a third of output growth between 1995 and 1999. Investment in information processing equipment and software now makes up more than a third of all private nonresidential fixed investment. Between 1990 and 1997 the number of information technology firms increased by 120 percent.

Technological innovation has been particularly important to the New Economy for two reasons. First, the information technology sector itself is highly productive, and as this sector has grown, its improved productivity performance has boosted that of the economy as a whole. Second, the adoption of information technology by other sectors of the economy has led to performance gains there, making other inputs—both physical and human capital—more productive through changes in the way firms do business. Manufacturing plants are increasingly automated. Workers are being given more flexible job assignments and stronger incentive pay. Supplier relationships are becoming more closely integrated through the use of computer systems that coordinate the various aspects of production and warehousing, allowing firms to slash their inventories. Firm boundaries are also shifting rapidly, as firms outsource noncore businesses and move toward flexible, collaborative relationships such as strategic alliances with suppliers, customers, and even rivals.

But technology alone is just a tool. It is only when firms use technology wisely that it becomes a transforming agent. Performance improvements are most likely to be realized when firms use information technology to bring about changes in basic business practices, job design, organizational structure, interactions with customers and suppliers, and human resource practices.

One example of how technology is inspiring changes in business practices is the use of the Internet to reduce companies' procurement costs. On-line business-to-business exchanges now offer a range of transaction tools, such as on-line auctions, billing, insurance, information, and other custom services, that make procurement far more efficient. One on-line exchange claims to have saved customers $2 billion during its 5 years in operation. These kinds of improvements, in turn, help make the economy more resilient: more efficient procurement and inventory management have greatly reduced the tendency toward inventory overhang in the economy as a whole, thus reducing the likelihood that a period of slowing growth will tip into a recession.

The Role of Policy in Supporting the New Economy

The surge in innovation and entrepreneurship that is driving the New Economy has been fostered by supportive government policies. First and foremost, policy played a critical role in boosting national saving, which provides the fuel on which the New Economy runs. The Federal budget deficit had ballooned to $290 billion in 1992, the largest ever, and it was projected then to grow to more than $455 billion by fiscal 2000. These massive deficits placed a huge drain on investment capital, and partly as a consequence, economy-wide productivity growth had fallen to anemic levels. However, with the program of fiscal discipline that President Clinton and Vice President Gore put in place in 1993, the fiscal balance has improved 8 years in a row. The surplus in fiscal 2000 was $237 billion, the largest as a share of GDP since 1948.

These mounting surpluses mean that the government, rather than draining resources away from private investment, is now freeing them up. And indeed, the last 8 years have seen a dramatic increase in investment. From the first quarter of 1993 to the third quarter of 2000, investment grew at an average rate of 13 percent per year. This long investment boom has been key to the increasing productivity growth we have seen over the course of the expansion, which, in turn, has enabled the economy to continue on a path of strong yet noninflationary growth.

The ascent of the New Economy was also helped along by strong, pro-competitive policies that allowed innovation to flourish. The Telecommunications Act of 1996, for example, opened up competition among local telephone companies, long distance providers, and cable companies. That competition, in turn, helped spur innovation not only within telecommunications but also in computer technology and related sectors that have been key drivers of the New Economy. The act also provided guidelines to ensure that the benefits of increased competition would be harnessed so as to increase the circle of opportunity. It established the E-rate program, through which schools and libraries gained access to discounted telecommunications and Internet connections. Today 95 percent of public schools are connected to the Internet. This program, paired with a massive increase in Federal funding for education technology (to $872 million in fiscal 2001, up from just $23 million in fiscal 1994) constitutes a long-term investment in the technologically skilled work force needed to sustain economic growth.

Globalization and the New Economy

Globalization has also played a crucial role in promoting the technological innovation and organizational changes that have yielded a New Economy. Globalization turns national markets with few competitors into worldwide markets with many competitors. The resulting, more intense competition induces firms to innovate. That innovation contributes to increased productivity and economic growth. Globalization, by expanding markets, also gives producers greater scope to specialize in what they do best. And with open markets, they are able to use the best and most cost-effective inputs from sources around the world to lower their costs.

Improvements in information technology have spurred deeper integration between the United States and the world economy. Indeed, it is no coincidence that the New Economy emerged in the United States at the same time that U.S. participation in the global economy has reached new heights, because globalization and the recent advances in information technology are integrally linked.

Over the past 8 years, fostering globalization and its benefits has been a high policy priority. The United States has been a partner to more than 300 trade agreements, including the North America Free Trade Agreement, the Uruguay Round multilateral trade agreements, the accord establishing permanent normal trade relations with China, the international moratorium on tariffs on e-commerce, and multilateral agreements in telecommunications, information technology equipment, and financial services. At the same time, U.S. trade policy has taken pains to ensure that these agreements safeguard global natural resources and respect our values, including our commitment to core labor standards.

The effects of globalization and improved communications and technology are evident in the record of U.S. international transactions. Trade in capital goods has soared since 1996, with particularly strong growth in products that are central to the New Economy, such as computers, semiconductors, and telecommunications equipment. Exports of services have also grown, in particular in those service industries where valuable innovation has taken place, such as professional, business, technical, and financial services.

Harnessing the New Economy

For all the power and promise of the New Economy, we cannot take for granted that its benefits will flow spontaneously to all. That is where policymakers have played a critical role in harnessing the dynamism of today's New Economy to benefit all Americans, including groups that have too long been left behind.

A robust economy that creates 22 million new jobs certainly provides broad-reaching benefits. Unemployment rates for African Americans and Hispanics, for example, have hit record lows during this expansion. But rather than rely on the pure market effects of an economy running on all cylinders, this Administration has enlisted additional means to empower and assist struggling families. Among the accomplishments thus far have been two hikes in the minimum wage, an expansion of the Earned Income Tax Credit, a more than doubling of funding for child care for working parents, and the extension of health insurance coverage to a greater number of low-income children and working families. Together with the effects of the strong economy, these measures have helped 7 million people move out of poverty since 1993.

Over the past 8 years, the welfare rolls dropped by more than 8 million, or nearly 60 percent, to their lowest level in 32 years. Recent data submitted by States competing for high-performance bonuses available under welfare reform show that 1.2 million welfare recipients nationwide went to work in fiscal 1999 alone. Seventy-seven percent of those who got jobs were still working in the next quarter, and average quarterly earnings were up 31 percent from the first to the third quarter of employment: from $2,027 to $2,647. And as more people move off of welfare, into the job market, and out of poverty, their greater economic participation has a positive feedback effect on the economy as a whole, lessening the burden on the budget and on taxpayers and increasing the productive force in the economy.

Here, too, technology can make important contributions, by improving the delivery of many social services. In health care, such innovations are yielding new treatment methods that can directly improve the quality of life for many. In education, new Federal programs are bringing computers and the Internet into the classroom, narrowing the digital divide, helping improve teacher effectiveness, and reducing class size.

Despite vast improvements in the quality of life experienced by many Americans, challenges remain. There are still substantial disparities in economic well-being across regions. Minority groups and residents of central cities and rural areas suffer disproportionately high rates of poverty and unemployment.

Our health care system also presents challenges. We need to control health expenditures and ensure that care is affordable to all. Issues related to managed care and the appropriate way to align incentives must be resolved so that health care is neither overly restricted nor overly prescribed. Even after these problems are brought under control, many Americans may continue to lack health insurance. If this is allowed to happen, they will be unable to take advantage of the quality care available to the majority.

Finally, one side effect of the New Economy is that certain parts of the country, especially the perimeters of some of our large cities, have experienced enormous growth in jobs and population. Such growth, when left unchecked, has led to sprawl and serious environmental consequences.

Even at this moment of great prosperity, then, great challenges remain to be confronted. We have a unique opportunity today to harness the power of the high-technology, high-productivity, high-growth New Economy in a way that sustains the current prosperity and uses it to improve the lives of all Americans. The challenges of the future—from saving Social Security, to improving education, to expanding health care coverage, to paying down the national debt—are significant and will require concerted effort. The tools and capabilities of the New Economy, combined with the right, targeted policies, can provide a powerful solution toward addressing these challenges as a Nation.